

**LEGISLATIVE SERVICES AGENCY  
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301  
Indianapolis, IN 46204  
(317) 233-0696  
<http://www.in.gov/legislative>

**FISCAL IMPACT STATEMENT**

**LS 6222**

**BILL NUMBER:** SB 13

**NOTE PREPARED:** Nov 7, 2006

**BILL AMENDED:**

**SUBJECT:** Income Tax Deduction for Military Service.

**FIRST AUTHOR:** Sen. Weatherwax

**BILL STATUS:** As Introduced

**FIRST SPONSOR:**

**FUNDS AFFECTED:** ☒ **GENERAL**  
☒ **DEDICATED**  
**FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill increases the maximum Income Tax deduction for income received for military service from \$2,000 to \$5,000.

**Effective Date:** January 1, 2007 (retroactive).

**Explanation of State Expenditures:** The Department of State Revenue (DOR) will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the increase in the military service income deduction. The DOR's current level of resources should be sufficient to implement these changes.

**Explanation of State Revenues:** The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who receive military service income. The revenue loss due to this bill could potentially total \$3.9 M in FY 2008 and about \$3.97 M in FY 2009. The revenue loss is expected to increase thereafter by about 1.4% annually.

*Background:* Under current statute the maximum deduction for income from military service that a taxpayer is entitled to claim is \$2,000. The bill would increase this maximum by \$3,000 beginning in tax year 2007. Data from the Department of State Revenue indicates that 36,530 taxpayers claimed the military service deduction in tax year 2004. These taxpayers deducted approximately \$72.5 M in AGI. This resulted in a revenue loss of about \$2.5 M in FY 2005. The fiscal impact is based on annual income tax return information and census and pay rate data for military personnel and retirees in Indiana reported by the U.S. Department of Defense (DOD). It is assumed that the \$3,000 increase will be claimed by all current taxpayers since 2003-2006 census and pay data from the DOD indicates that the average annual pay for military personnel and

retirees in Indiana exceeds \$5,000. Some military retirement income (i.e., disability retirement income) is currently not taxable under the federal income tax and, as a result, is already excluded from Indiana AGI. Recent DOD retirement pay data does not delineate between taxable and tax-exempt military retirement payments to Indiana retirees. However, the proportion that is tax-exempt is not expected to exceed 10% of total retirement payments. Thus, the revenue loss from the bill could be somewhat lower to the extent that DOD's military retirement payments to Indiana retirees reflect federally tax-exempt retirement income. Since the increase in the military service deduction is effective beginning in tax year 2007, the fiscal impact would begin in FY 2008. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** Because the proposed increase in the military service income deduction would decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties with local option income taxes.

**Information Sources:** OFMA Income Tax databases, 1996-2004; Deborah K. Williamson, U.S. Department of Defense, Defense Manpower Data Center, (831) 583-2400.

**Fiscal Analyst:** Jim Landers, 317-232-9869.